24. For example, suppose that Sprint and Nextel were to contract to permit Nextel customers to have access to a CDMA network more quickly by sharing Sprint's network and investing jointly to expand and upgrade that network. Such a venture would require Sprint and Nextel to share investment costs according to some formula. This formula would be difficult to negotiate because it would require the parties to agree about their relative benefits. Moreover, a formula that allocated network costs according to the parties' relative usage could have the effect of discouraging each from lowering its price in order to expand its output, since expansion would have the effect of increasing its share of the network costs. The parties may also disagree about the appropriate treatment of the intellectual property that is developed through the venture, for example, whether to maintain it as a trade secret, patent it for internal use, or license it to others.

25. Similar difficulties would arise if the parties were to attempt through contract to permit customers on their respective networks to communicate with one another through the push-to-talk feature. Such integration would provide greater competitive benefits to Sprint, which might make Nextel reluctant to share its technology without significant compensation. If that payment were to involve a per subscriber charge, prices could increase. If it were a lump sum charge, Nextel would have the incentive to overstate the value of its technologies and Sprint would have the incentive to understate Nextel's contributions. If the integration required further investments by Nextel and Sprint, each would prefer a technical solution that gave it a competitive advantage. There is no reason to think that teaming between Sprint and Nextel would be successful or timely in resolving these problems. Consequently, these benefits are merger-specific.

## B. Improved Network Coverage

26. The merger will also result in better service quality for Sprint Nextel's wireless customers through a combination of improved signal strength, fewer dropped calls, and greater geographic

coverage. These benefits cannot be achieved as efficiently through either roaming agreements or sharing cell sites. Sprint Nextel will be able to reduce the number of overlapping cell sites while, at the same time, improving the quality of its service.[11]

27. Significantly, in a recent survey of departing Nextel customers, more than [ ] said that they dropped their Nextel service because of network performance and coverage problems.[12] A recent survey of departing Sprint customers obtained a similar result.[13] Because the merger will produce improvements in service, Sprint Nextel will be a stronger competitor. Moreover, expanded geographic coverage will permit Sprint Nextel to avoid some charges that Sprint customers currently incur when they roam into areas where there is no Sprint branded wireless service

28. By permitting the companies to deploy their sites more efficiently by eliminating overlap in their current service areas, the merger will also reduce the cost and improve the quality of service experienced by the subscribers of the combined company. The combined company plans to deploy significantly fewer new cell sites than were planned to be added by Sprint and Nextel in the absence of the merger, in part because a significant number of additional Sprint cell sites can be collocated on existing Nextel sites. This will result in savings in site development and leasing costs as well as operating expenses while improving CDMA network in-building coverage, overcoming weak signal coverage and coverage gaps, and adding capacity. In addition, Sprint and Nextel plan to consolidate a

[11] See Joint Declaration of Oliver Valente and Barry West (hereinafter Valente-West Declaration) ¶ 52 for a discussion of this issue.

[12] This is based on the percentage of surveyed ex-customers who said that network performance or coverage problems were their primary reason for terminating Nextel service. (The calculation excludes customers who were terminated by Nextel for non-payment.) The specific reasons given for network performance and coverage problems were: (a) dropped calls; (b) holes or dead spots in the network; (c) in-building coverage; (d) system outages, and (e) need to expand coverage.

[13] Approximately [ ] of exiting Sprint customers who were interviewed in the summer of 2004 cited network issues as one of the main reasons for leaving.

number of currently collocated Sprint sites into existing Nextel base station shelters and towers, thereby achieving additional cost reductions.

29. At the same time, the geographic coverage of the Sprint Nextel CDMA network will be greater than the area that would otherwise have been covered by Sprint's own CDMA network.[14] Instead of duplicating cell sites in the same geographic areas, the merged firm will deploy its CDMA network in areas currently served by Nextel that Sprint would not otherwise have served. The greater coverage and other improvements in service quality likely will reduce subscriber churn, thus reducing the cost incurred by Sprint Nextel in acquiring and retaining subscribers. This will give the merged company the incentive and ability to reduce the prices that it charges.

30. These benefits are merger-specific. Both Sprint and Nextel have attempted to expand their coverage through a combination of cell site sharing and roaming agreements, but these individual efforts are more costly, and produce fewer benefits, than can be achieved through the merger. Cell site sharing can overcome some of the inefficiencies of serving areas with small numbers of subscribers, but it is often logistically difficult and, in any event, it does not produce savings in equipment costs. We also understand that roaming often produces an inconsistent service experience, for example, by preventing subscribers from using certain features to which they have subscribed.[15]

31. Roaming agreements frequently involve substantial expenditures for roaming fees, in large measure because of imbalances in roaming usage among carriers. These costs are either passed on directly to roaming subscribers or included in the costs that carriers must recover from their entire

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[14] The Commission has previously noted the consumer benefits from expanded network coverage. See, e.g., *Cingular-AT&T Wireless Order* ¶ 217.

[15] We understand that Sprint customers do not experience this degradation when they roam into areas served by Sprint affiliates and Nextel customers do not experience this degradation when they roam into areas served by Nextel Partners.

customer base. After the merger, Sprint Nextel will avoid some of the charges that Sprint currently incurs when its subscribers roam into areas in which it does not have coverage.[16] For example, in areas where Sprint currently pays roaming charges and where the combined firm will deploy its own CDMA network after the merger, these charges will be avoided. Sprint estimates that its per minute cost for a roaming call is more than 7 times its per-minute cost of a non-roaming call.

## C. Cost Savings from Increasing the Proportion of "On-Network" Traffic

32. As the Sprint and Nextel networks are combined, the merger will permit Sprint Nextel to avoid some of the interconnection charges that they currently pay to ILECs for completing calls that transit between the separate Sprint and Nextel networks because those calls will now be completed through direct connection. Although Sprint Nextel will incur some incremental costs for this additional on-network traffic, the merger still will produce substantial savings as the proportion of traffic that remains on the Sprint Nextel network increases. Similarly, as the traffic on the two separate networks is combined, direct interconnection with other wireless carriers will (because of the greater combined volume) become economical where it is not today.[17]

33. Sprint has estimated that the per-minute cost of a call from one of its subscribers to someone off its network is approximately 19 percent greater than the per-minute cost of a call between two Sprint PCS subscribers. This gives some indication of the likely cost savings from this source. These cost savings will permit Sprint Nextel to lower the prices that it charges to subscribers and will give it the incentive to do so.

[16] The Commission credited such savings in its Order approving the Cingular-AT&T Wireless transaction. *Cingular-AT&T Wireless Order* ¶ 233. We understand that Sprint customers do not incur these costs when they roam into areas served by Sprint affiliates.

[17] Valente-West Declaration ¶ 22.

D. Reduced Equipment Procurement Costs

34. Nextel customers will benefit from lower handset costs as they migrate to the Sprint Nextel CDMA network. Wireless carriers charge less for handsets than their own procurement costs, and this subsidy represents a significant subscriber acquisition cost. The merger is expected to reduce handset procurement costs. As a result, Sprint Nextel will be able to reduce the prices that it charges to subscribers, either by reducing the price of monthly service, handsets, or both.

35. Motorola currently is Nextel's primary handset supplier.[18] In contrast, Sprint currently has four handset suppliers, which leads to more intensive competition than among the suppliers that serve Nextel.[19] Although Nextel might have been able to obtain some of these benefits if it had developed its own CDMA network, these benefits now will be available sooner for the current Nextel customers who choose the Sprint Nextel CDMA network.

36. In addition, Sprint Nextel will be able to obtain lower equipment costs, for both handsets and network infrastructure, than Sprint or Nextel could have achieved alone because Sprint Nextel will be able to offer larger orders over which suppliers can amortize their research and development costs, and because larger orders result in lower costs through increased supplier experience. As a result, equipment suppliers will have an incentive to offer lower handset and network infrastructure prices to the merged entity than they would to Sprint and Nextel absent the merger. Sprint Nextel subscribers will benefit from these lower costs.

37. These benefits of reduced procurement costs are merger-specific. Although Nextel customers eventually may have benefited from competition among equipment suppliers after Nextel

[18] See Valente-West Declaration ¶ 42.

[19] For an analysis of the effect of multiple supply sources on procurement costs see J.J. Anton and D.A. Yao, "Split Awards, Procurement, and Innovation," *Rand Journal of Economics*, Winter '89, pp. 538-552.

transitioned to CDMA or another next generation network, these benefits will be achieved more quickly as a result of the merger.

38. Finally, the larger equipment orders that will be placed by Sprint Nextel may increase competition among suppliers. This can occur because suppliers will have increased incentives to avoid being "shut out" of any given large long-term procurement. These cost savings from larger equipment orders also are merger-specific.

E. Reduced Backhaul Costs

39. Sprint Nextel customers will also benefit because a substantial proportion of Nextel's backhaul traffic will be carried on Sprint's wireline network after the merger instead of facilities that Nextel currently leases from other carriers. Nextel currently leases landline facilities from other carriers in order to connect its cell sites to its switches and to the facilities of local exchange carriers.[20] In contrast, a substantial portion of Sprint's traffic is carried on its own facilities, including the Metropolitan Area Networks that it maintains. The prices that Nextel pays for this backhaul exceed Sprint's incremental costs. Therefore, the merged firm expects to achieve significant cost savings by moving Nextel traffic to the Sprint network. The cost savings from using Sprint's local backhaul facilities are analogous to gains from eliminating "double marginalization" in a vertical merger.[21] Because these savings will affect the incremental costs incurred to carry current Nextel traffic, they can be expected to reduce the prices charged.

40. These benefits also are merger-specific. Although pricing inefficiencies sometimes can be eliminated in arms-length contracts, perhaps through the use of complex non-linear pricing systems, it often is difficult to do so in practice because usage is difficult to predict accurately. In this regard,

[20] Valente-West Declaration ¶ 20.

[21] That is, Sprint would, in effect, be providing an input to Nextel at marginal cost.

Nextel's current backhaul contracts do not levy a marginal price equal to cost, as evidenced by the cost-savings that the merger would achieve.

F. Improved Development of Services at 2.5 GHz

41. Sprint Nextel will face serious challenges to provide service over 2.5 GHz, including dealing with the propagation characteristics of the spectrum, choosing among still-developing technology options, assembling appropriate blocks of spectrum in the midst of the process of rebanding, designing a service that meets consumer demands, and confronting competition from other new services.[22] Sprint Nextel is more likely to succeed in meeting these challenges than either of the individual firms alone.

42. The geographic footprint of Sprint Nextel's 2.5 GHz rights will be larger than that covered by the rights of either firm alone and will allow 2.5 GHz service by the merged firm to reach more potential subscribers. By sharing development and deployment costs, Sprint Nextel will have greater incentives to undertake the development and deployment of innovative, high-speed multimedia wireless services than would Sprint and Nextel separately.

43. The greater reach of Sprint Nextel service also is likely to result in efficiencies in acquiring network and subscriber equipment. Such efficiencies would permit Sprint Nextel to offer 2.5 GHz services at lower prices than either firm could alone.

44. Finally, nearly nationwide Sprint Nextel service is likely to result in service that consumers find more valuable than service the individual companies could provide over more limited geographic areas, even if there were roaming agreements. Increasing the area served by a unified network will increase the value of service to some consumers if roaming would otherwise reduce the functionality of

[22] For more details, see the Joint Declaration of Todd Rowley and Robert Finch (hereinafter Rowley-Finch Declaration).

service. The larger network will also reduce the roaming charges paid by Sprint Nextel. In addition, because the Sprint Nextel network for 2.5 GHz service will be larger, suppliers of complementary services – e.g., applications suppliers – are likely to find it more attractive to supply Sprint Nextel than it would be to supply either of the merging parties. These factors will increase both the range and quality of the services that the merged entity will be able to offer to its subscribers and to reduce the cost of offering them.

45. It is unlikely the two companies could achieve similar efficiencies without merging. Sprint and Nextel previously discussed a joint venture to pool the BRS spectrum holdings of the two companies. However, the venture was never formed.[23] Both companies apparently were concerned about the governance of the venture, including how contract disputes would be resolved and how incentives for efficient behavior would be maintained as new information became available. In addition, differences in the wireless networks that the two companies would continue to maintain separately led to differences in their incentives with respect to the joint venture. Finally, both firms apparently were concerned about the effect of possible future material changes in the status of its partner on the viability of the joint venture.

46. These barriers to teaming are the types of transactions costs discussed earlier and provide a concrete example of the types of difficulties that cooperation short of merger entails. The merger of Sprint and Nextel will overcome these difficulties while, at the same time, achieving the benefits that the parties hoped to receive from the joint venture.

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[23] For more details, see the Rowley-Finch Declaration.

## III. Structural Screens for Competitive Effects Analysis

47. In this section, we define the relevant antitrust markets for evaluating this transaction. We then conduct an initial structural evaluation of the merger, similar to the one that the Commission performed in its review of the Cingular-AT&T Wireless transaction. We adjust the levels used in the Commission's structural screens to take into account a number of key structural differences between the Sprint-Nextel merger and the Cingular-AT&T Wireless combination, particularly the fact that Sprint and Nextel are not major ILECs. What these differences mean is that the Sprint-Nextel merger raises fewer competitive risks than did the Cingular-AT&T Wireless merger and, consequently, that the initial structural screens used by the Commission in Cingular-AT&T Wireless should be relaxed somewhat to account for these lower risks. In subsequent sections, we follow the approach used by the Commission in evaluating the Cingular-AT&T Wireless transaction by examining in greater depth those markets that are identified by the initial screens as requiring further competitive analysis.

### A. The Relevant Product Market

48. In its *Cingular-AT&T Wireless Order*, the Commission concluded that the relevant wireless product market includes all mobile wireless services, both interconnected voice and data. In this Declaration, we follow the Commission and adopt this market definition. The Commission also concluded that, although there may be separate antitrust markets for enterprise (i.e., business, government, institutions) customers and residential (non-enterprise) customers, "enterprise customers tend to be high-volume users of mobile voice services {and} competition among carriers to attract and retain enterprise customers is likely to be relatively intense."[24] For this reason, the Commission concluded that the evaluation of a market that combined services to these two sets of customers would not result in any understatement of possible competitive harm to the market for enterprise services. In

[24] *Cingular-AT&T Wireless Order* ¶ 79.

this Declaration, we follow the Commission's approach of combining enterprise and residential service into a single market.

B. Competition in the Supply of Wholesale Wireless Services

49. One also might wish to consider whether to treat wholesale services, (i.e., the sale of wireless mobile services to entities that retail those services to final consumers) and retail services as separate markets. A number of suppliers purchase wholesale wireless services from Sprint and other carriers and then resell them to final consumers. Sprint's wholesale customers include Virgin Mobile and Qwest. Under these arrangements, network and feature functionality are provided by Sprint and the wholesale customer generally provides all other services (e.g., branding/marketing, billing, and customer care). We understand that final customers regard the retail sellers (i.e., wholesale purchasers) as their suppliers.

50. Some Sprint wholesale customers purchase minutes of use and data packets, often with a volume discount, and create and price their own retail packages. Others purchase pre-packaged bundles of voice and data at wholesale prices, which include a monthly recurring charge and a charge for "overage" (i.e., minutes that exceed the maximum in the package). Some wholesale customers operate nationally and attempt to serve all types of customers, while others operate in regional, demographic, or other market niches. For example, Qwest generally operates in its ILEC territory, and Virgin Mobile seeks young users who use pre-paid service.

51. It is our understanding that Sprint, Cingular, and Verizon Wireless together provide service to about 95 percent of all subscribers who are served through a wholesale intermediary, and that competition among these carriers is vigorous. We also understand that Nextel is not a supplier of wholesale services. Thus, the merger of Sprint and Nextel will not increase concentration among existing suppliers of wholesale wireless services. Although, in principle, Nextel could become a

supplier to wholesale customers at some point in the future, so could T-Mobile. Thus, even if Nextel were eliminated as a potential entrant, another potential entrant has sufficient capacity to absorb a large number of end users who are served through wholesale intermediaries.

52. Moreover, our analysis of competition indicates that other carriers generally have sufficient capacity to absorb not only those Sprint Nextel retail customers who would wish to switch carriers in response to a post-merger price increase, but also those customers whom Sprint currently serves through its wholesale customers. In fact, in calculating market shares, we conservatively have assigned to Sprint those retail customers whom Sprint indirectly serves through its wholesale customers.

53. In addition, some wholesale customers purchase the underlying service for a lump sum or fixed unit price under long-term contracts. A post-merger increase in retail prices would lead such wholesale customers to expand their retail output in response. These wholesale customers, who independently set their own retail prices, thus act as independent constraints on retail pricing by the underlying carriers.

54. Finally, the presence of retail competition constrains the prices that can be charged at wholesale. Because the merger of Sprint and Nextel will not harm retail wireless competition, it also will not harm wholesale competition.[25]

[25] It might be argued that, post-merger, the combined firm would have a heightened incentive to restrict sales to wholesale customers that compete downstream with the combined firm. However, if the merged firm lacks the ability to raise downstream prices even if it were to acquire all of the wholesale customers' subscribers, and if there is competition in the provision of wholesale services, then the merged firm would have no incentive to restrict those sales. Thus, for the same reasons that the merger is unlikely to produce higher wholesale prices as a result of reduced competition among wholesale suppliers, this type of vertical foreclosure is also unlikely.

C. The Relevant Geographic Market

55. In the *Cingular-AT&T Wireless Order*, the Commission concluded that the relevant geographic markets were local areas. In particular, the Commission evaluated subscriber shares within Component Economic Areas (CEAs), as defined by the Bureau of Economic Analysis of the Department of Commerce,[26] and Cellular Market Areas (CMAs), the geographic areas used by the Commission in its initial cellular licensing proceeding.

56. The Commission used two sources of subscriber data: Numbering Resource Utilization/Forecast (NRUF) data, which track telephone numbers used by all telecommunications carriers, including wireless carriers, and are collected "on a rate center area basis";[27] and billing data that were submitted by the six nationwide carriers "in response to a staff data request"[28] from which the Commission calculated the number of subscribers per zip code for each carrier. The Commission then aggregated these subscriber data to CEAs and CMAs. As discussed below, we use Telephia data to delineate the local markets in our analysis.[29]

57. The Commission concluded that there was enough local variation in mobile prices to reject the national market definition proposed by Cingular and AT&T Wireless.[30] In this Declaration, we follow the Commission and assume that the relevant geographic markets are local.[31]

[26] See K.P. Johnson, "Redefinition of the BEA Economic Areas," *Survey of Current Business*, February 1995, pp. 75-81.

[27] *Cingular-AT&T Wireless Order* ¶ 102. According to the Commission, rate centers are generally smaller than counties. However, a subscriber can be served by a rate center that is located in a county other than the one in which he resides.

[28] *Id.* ¶ 103.

[29] We did not have access to the NRUF and carrier billing data in preparing this Declaration.

[30] *Id.* ¶ 88.

[31] Although we adhere to the Commission's geographic market definition for purposes of this Declaration, we note that the five nationwide carriers advertise both prices and packages on a national

D. Applying the Commission's Initial Structural Screens

58. In the Cingular-AT&T Wireless matter, the Commission employed several initial "structural screens" to identify those local geographic areas (i.e., CEAs and CMAs) that warranted further detailed competitive analysis. There was no presumption that these markets would raise competitive concerns and, in fact, almost all of the markets that received more detailed analysis were ultimately found by the Commission to raise no such concerns.

59. The Commission used three structural screens in its initial analysis. The first screen identified for further analysis markets in which the post-merger Herfindahl-Hirschman Index ("HHI") would be 2800 or higher and the change in the HHI (i.e., the "Delta HHI") would be equal to or greater than 100 points. The second screen identified markets in which the change in the HHI would be 250 or higher, regardless of the post-merger HHI. The third screen identified markets where the merging parties would hold at least 70 MHz of wireless spectrum after the merger. The markets that were identified by these screens were subject to further analysis to determine whether there would be potential competitive harms if the transaction were approved without restrictions.[32]

60. Because we did not have access to the NRUF and carrier billing survey data used by the Commission in connection with the Cingular-AT&T Wireless proceeding, our analysis relies upon market share data purchased by Sprint and Nextel from Telephia.[33] We understand that the Telephia

level. This national strategy of these carriers could create competitive linkages across the local markets and constrain the ability of the carriers to discriminate among local markets.

[32] *Cingular-AT&T Wireless Order* ¶ 112.

[33] We understand that the Commission intends to employ data from NRUF and carrier billing records in its review of the Sprint-Nextel merger, and we would be interested in analyzing these data, as well.

data are widely used by wireless carriers in developing their competitive strategies.[34] We applied the Commission's initial structural screens to all of the local markets for which we have Telephia data.

61. The Telephia data provide estimates of market shares for wireless carriers in 235 local markets, each of which is a collection of counties. Market share data for 102 markets are based on consumer surveys regularly conducted by Telephia (Telephia Attitude and Behavior Survey (TABS)). Using a somewhat different methodology, Telephia estimates market shares for 133 ("snapshot") markets on an occasional basis. For these markets, Telephia determines market shares by using subscriber estimates that are obtained by electronically "querying" a panel of numbers and counting as subscribers those that return signaling information. Virtually all of the Telephia data are from 2004. (Data for six snapshot markets are from 2003.) In conducting our analysis, we conservatively included the shares of Sprint's affiliates and wholesale customers and Nextel Partners in the shares of Sprint and Nextel, respectively, which tends to overstate their market shares.

62. Table 1 lists the 235 Telephia local markets that we used in our analysis, detailing the subscriber shares of each carrier within those markets.[35] Table 2 shows the results of applying the Commission's two initial HHI-based structural screens to these markets. It lists those markets for which the post-merger HHI is 2800 or greater and for which the change in the HHI is 100 or greater. Table 2 also lists the additional markets for which the change in the HHI is 250 or greater.

63. Of the 235 Telephia markets, these screens identify 95 markets for further analysis. For example, San Angelo TX and Hammond LA would require more detailed evaluation because of high

[34] Although we have no reason to believe that there would be any significant difference between conclusions based upon the Telephia data and those based upon the NRUF data or carrier billing data, this view can only be confirmed after we have had the opportunity to analyze the additional databases.

[35] All tables appear in Appendix 2 to this Declaration.

post-merger HHIs (3380 and 5690, respectively). Gainesville FL is identified because the change in the HHI is 267.

64. The Commission's third initial structural screen identifies markets where the combined firm would have at least 70 MHz of spectrum, which represents about 35% of the spectrum available to provide CMRS in each market. The combined spectrum holdings of Sprint and Nextel would not reach 70 MHz in any of the Telephia markets that we examined, and most are well below that amount.[36] Thus, applying this screen does not add to the list of markets for which more detailed analysis is needed, according to the Commission's methodology.

E. Adjusting the Commission's Screens

65. Ninety-five Telephia markets would be identified for further competitive analysis if the structural screens used in the Cingular-AT&T Wireless transaction were applied to the Sprint-Nextel merger. However, the thresholds used by the Commission in the Cingular-AT&T Wireless transaction likely overstate the number of markets that deserve closer analysis in the Sprint-Nextel transaction. This is because the HHI levels in the screens used in Cingular-AT&T Wireless fail to account for several differences between the two mergers, differences that cause the competitive incentives of the merged firms in the two transactions to diverge.

66. First, Nextel is not an ILEC and the Sprint ILECs account for fewer than 5% of all switched access lines, all of which are intended to be spun off after the merger. By contrast, SBC and BellSouth, the owners of Cingular, account for more than 45% of all switched access lines. Second,

[36] Sprint and Nextel provided spectrum data to us on a BTA basis. We mapped the BTAs into Telephia markets using the county definitions of the Telephia markets and BTAs. Most Telephia markets were contained within one BTA. However, for those Telephia markets whose counties spanned more than one BTA, we matched the Telephia market with the most populated BTA. It should be understood in what follows that Telephia is the source of the subscriber market shares and Sprint and Nextel are the sources of the spectrum holdings data.

Sprint Nextel will generally have lower spectrum holdings than did Cingular-AT&T Wireless. Finally, the Commission may find that the Sprint-Nextel merger creates larger and more credible efficiency benefits than did the Cingular-AT&T Wireless transaction.

67. These three factors predictably lower the competitive risks raised by the Sprint-Nextel merger as compared to the Cingular-AT&T Wireless transaction. This suggests that the Commission should evaluate the Sprint-Nextel merger with more permissive initial structural screens.[37] In our analysis, we adjust the thresholds used in the screens to account for this lower risk. We discuss the three relevant risk factors in turn.

1. ILEC Integration

68. The most important differentiating risk factor is that the Cingular-AT&T Wireless transaction involved the acquisition of an independent wireless carrier by an entity owned by two major ILECs. This structural characteristic significantly increases the incentive to raise wireless prices and also raises intermodal competition issues that could lead to both higher wireline and wireless prices. In light of Sprint's far smaller presence as a local exchange carrier, and the fact that Sprint Nextel intends to spin off its limited ILEC holdings shortly after the merger is consummated, this factor is not a significant consideration in the Sprint-Nextel merger. This difference in incentives is the most important rationale for applying more relaxed structural screens to the Sprint-Nextel merger.

69. Relative to an independent wireless provider, an ILEC-affiliated wireless provider has less incentive to lower wireless prices in areas in which it is the local exchange carrier. This is because

[37] The fact that this merger reduces the number of national carriers from 5 to 4, and reduces by 1 the number of carriers in any local market where both Sprint and Nextel currently provide service, should not lead the Commission to consider reducing the HHI thresholds in the screens. A market with a HHI of (say) 2700 and a HHI delta of (say) 75 is not more prone to possible adverse competitive effects in this matter than in the Cingular-AT&T Wireless matter. Of course, the Commission's initial screens in this merger will identify more markets because the screens take the earlier transaction as given.

lower wireless prices encourage some wireline customers to switch to wireless service, which reduces wireline profits. Thus, an ILEC-affiliated wireless provider would only value the *incremental* profits associated with a wireline-to-wireless subscriber switch, whereas an unintegrated wireless provider would value the *total* profit from adding a new subscriber to its wireless service. This adverse intermodal pricing incentive effect arises even if substitution between wireless and wireline is limited mainly to secondary lines and the two products comprise separate relevant antitrust markets.[38] The magnitude of the impact on pricing incentives depends on the gains to the ILEC-affiliated wireless carrier from obtaining wireless customers from other wireless carriers as compared to the costs of "cannibalizing" its existing wireline customers.[39]

70. In addition, an ILEC that is integrated into, and has a substantial share of, wireless service, also has the incentive to raise *wireline* prices relative to an unintegrated ILEC. This is because the integrated ILEC recognizes that higher wireline prices would cause some substitution to its own wireless carrier. In the case of Cingular-AT&T Wireless, the Commission could reasonably have concluded that the merger would increase somewhat the incentives of BellSouth and SBC to raise wireline prices because the now-affiliated AT&T Wireless would capture some of the lost customers. The extent to

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[38] Wireless services would not likely be such a potent constraint on wireline pricing that the antitrust market for wireline services would include wireless services under the market definition paradigm of the *Merger Guidelines*.

[39] ILEC-affiliated wireless carriers pay interconnection charges to themselves on in-region calls. This might appear to suggest they would earn a higher profit margin on a new subscription than does an independent wireless carrier, which would induce them to charge lower wireless prices. However, their incentives actually are more complex and likely push in the direction of higher prices. First, the ILEC-affiliated carrier would earn those same interconnection fees if instead the independent carrier obtained the customer, which eliminates any increased incentive to attempt to cannibalize the independent's subscribers. Second, as discussed in the text, the ILEC-affiliated carrier would want to charge relatively higher prices than would an independent, because it recognizes the opportunity cost of cannibalizing its own wireline subscribers. Thus, on balance, in a maturing wireless market, it is unlikely that the ILEC-affiliated wireless carrier would choose to set a lower price than would an otherwise comparably-situated independent.

which integrated ILECs can act on this wireline pricing incentive depends upon the effectiveness of regulatory oversight.

71. Finally, an ILEC that is integrated into wireless service has the incentive to degrade wireless rivals' access to its wireline network and to raise interconnection charges to competing wireless carriers, relative to an unintegrated ILEC. This exclusionary conduct would increase the integrated ILEC's profits. Here, too, the incentive and ability to engage in either type of exclusionary conduct depend upon the effectiveness of regulatory oversight.

72. This difference between the Cingular-AT&T Wireless transaction and the Sprint-Nextel merger implies that the Sprint-Nextel combination raises fewer competitive concerns. Although the Commission approved the Cingular-AT&T Wireless transaction, it viewed the loss of the independent (unintegrated) AT&T Wireless as cause for competitive concern. For example, the Commission observed that the record evidence "indicates that Cingular has developed and marketed many of its wireless products and services to complement—and specifically not to replace—residential wireline voice services."[40] The Commission also noted the clear contrast with AT&T's incentives: "unlike Cingular whose strategies are influenced by SBC's and BellSouth's concerns about its wireline revenues and access lines, {the pre-merger} AT&T Wireless is not likely to be concerned with the impact of its strategies on wireline revenues or access lines, except to the extent that they represent a potential source of new wireless customers. In fact, the documentary evidence indicates that AT&T Wireless sought to encourage mass market consumers to cut the {wireline} cord."[41] And the Commission recognized that the Cingular acquisition of AT&T Wireless would "further reduce Cingular's incentives to make

[40] *Cingular-AT&T Wireless Order* ¶ 244.

[41] *Id.* ¶ 243.

available wireless substitute offerings {for wireline}..." and may reduce AT&T's incentive to continue to market and develop these wireless substitutes.[42]

73. Of course, the reduced incentive to lower wireless prices by ILEC-affiliated wireless providers is not the only adverse consumer effect of the ILEC affiliation. In addition, at the margin, the incentive of the ILEC-affiliated wireless carrier to invest in wireless innovation and to deploy new services will also be reduced. For ILEC-affiliated wireless carriers, investing in innovations that make wireless a more attractive substitute for wireline service will tend to further cannibalize their ILEC's wireline offerings. As the Commission noted, "SBC and BellSouth influence the development of Cingular's products and services; that some of Cingular's products and services are focused on retaining/integrating with ... its corporate parents' wireline customers; and that SBC and BellSouth plan to use the acquisition of AT&T Wireless, to some degree, to further this goal."[43]

74. Because the Sprint-Nextel merger does not involve a significant ILEC affiliation, the Commission can safely apply more permissive initial structural screens to this transaction. Similarly, the Commission also should take the lack of ILEC affiliation into account in its more detailed market-by-market competitive effects analysis.

2. <u>Spectrum Holdings</u>

75. We understand that there are many geographic markets in which the combined Cingular-AT&T Wireless has substantial spectrum holdings. Cingular-AT&T Wireless has more than 60 MHz in 41 of the top 106 Telephia markets for which we have spectrum holdings data for major carriers. In contrast, Sprint Nextel will have more than 60 MHz in only 1 of the 106 markets. In none of the 235

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[42] *Id.* ¶ 245.

[43] *Id.* ¶ 244.

Telephia markets do Sprint Nextel's spectrum holdings exceed 68 MHz, and most are well below this amount.

76. This evidence indicates that there would generally be *less* spectrum capacity available to competitors if Cingular-AT&T Wireless were to attempt to raise its prices after the merger than if Sprint Nextel were to attempt to do so. Because lower spectrum holdings create a reduced incentive to raise prices, the merger of Sprint and Nextel raises fewer competitive concerns.[44] We take spectrum shares into account in our more detailed analysis of markets that are identified by the initial screens. However, this risk factor also suggests that the Commission can safely apply more permissive structural screens at the initial stage of its analysis.

### 3. Efficiency Benefits

77. In any merger, the overall consumer impact depends on the relative magnitudes and likelihoods of anticompetitive harms and procompetitive benefits. The Commission did not give significant weight to Cingular-AT&T Wireless' cost-saving claims in balancing potential public interest harms and benefits.[45] It follows that if the Commission finds larger or more credible efficiency benefits in the Sprint-Nextel merger than it found in the Cingular-AT&T Wireless transaction, the Commission can be somewhat more permissive with respect to its competitive effects analysis. Just as the Commission demands more significant efficiencies when the likely competitive harms are more significant, it can similarly accept somewhat greater competitive risks where the efficiencies are larger or more credible. If the Commission credits the cost-savings for the merger claimed by Sprint and

[44] This is true even for markets that pass the Commission's initial spectrum screen since the amount by which they pass the screen also is relevant.

[45] *Cingular-AT&T Wireless Order* ¶ 232.

Nextel, that finding also would suggest that the Commission could safely apply more permissive initial structural screens.

F. Analysis Using Adjusted Levels for the Structural Screens

78. Because the Cingular-AT&T Wireless transaction generally provided a more risky balance of public interest benefits and harms than does the Sprint-Nextel merger, it is appropriate for the Commission to utilize somewhat more relaxed initial structural screens. We present results for several different degrees of modification, corresponding to various degrees of confidence in the importance of the three risk factors. In particular, we replace the Commission's HHI screens (i.e., a 2800 post-merger HHI plus a 100 HHI increase, or a 250 HHI increase for any post-merger HHI) with three alternative screens that increase these levels by 10%, 15%, or 20%.

79. Table 3 illustrates the 10%-adjusted HHI screen as applied to the 95 Telephia markets identified for further analysis by the Commission's initial HHI screens. If the Commission's screen levels are increased by 10% (i.e., a 3080 post-merger HHI plus a 110 HHI increase, or a 275 HHI increase for any post-merger HHI), the number of Telephia markets identified by the screens is reduced to 79. For example, the adjusted screen does not identify San Antonio for further analysis, which was identified using the Commission's screen because the HHI change was 259.

80. Table 4 lists the Telephia markets that are identified by the Commission's initial structural screen. The second column lists those markets that are identified by the 10%-adjusted screen. If the Commission's screen levels are increased by 15% (i.e., a 3220 post-merger HHI plus a 115 HHI increase, or a 287.5 HHI increase for any post-merger HHI), the number of Telephia markets identified for further analysis declines to 70. The 9 additional markets that are no longer identified are the ones below the line in the second column of the Table. Finally, if the Commission's screen levels are increased by 20% (i.e., a 3360 post-merger HHI plus a 120 HHI increase, or a 300 HHI increase for any

post-merger HHI), the number of Telephia markets identified by the screens falls to 60. The 10 additional markets that are no longer identified for further analysis are the ones below the line in the third column of the Table.

81. In its *Cingular-AT&T Wireless Order*, the Commission did not presume that the markets that were identified for further analysis by its initial screens were necessarily ones in which the Cingular-AT&T Wireless transaction would harm consumers. Instead, the Commission undertook more detailed competitive analysis of these markets. This is because the Commission stated that "a calculation of the HHI in a market is only the beginning of our analysis of the competitive effects of the merger, because its purpose is to eliminate from further analysis markets in which there is no potential for competitive harm."[46]

82. We follow the same basic methodology in this Declaration. For purposes of this Declaration, we conservatively use the 10% adjustment factor, so that our more detailed analysis focuses on the 79 markets identified by these adjusted initial screens. Our assumption that the subscribers of Nextel Partners, Sprint's affiliates, and Sprint's wholesale customers are included in the Sprint Nextel share is also conservative, i.e., this assumption has the effect of identifying more markets for further analysis than might in fact be warranted. However, even if the Commission were to choose not to make any adjustments to its structural screens, the Commission should still account for the Sprint-Nextel transaction's lack of ILEC affiliation, lower spectrum holdings, and efficiency benefits when balancing the competitive harms and consumer benefits of this transaction.

[46] *Id.* ¶ 184.

## IV. Unilateral Effects Analysis

83. In its *Cingular-AT&T Wireless Order*, the Commission followed its initial structural analysis with a more detailed market-by-market evaluation of the potential for anticompetitive unilateral effects. The Commission focused on a number of factors that would be relevant to the evaluation of these effects. In this section, we first set out the framework for unilateral effects analysis. We then examine the key economic factors. These factors include the closeness of substitution between Sprint and Nextel, the potential for competitor repositioning and expansion, and the efficiency benefits of the merger.

### A. Unilateral Effects Framework

84. In the *Cingular-AT&T Wireless Order*, the Commission concluded that wireless service is a differentiated product. It then followed the basic framework in the *Merger Guidelines* for analyzing unilateral effects in differentiated product markets. We also follow that framework. We examine the likelihood that the merged firm would gain the power and incentive to raise its post-merger price unilaterally, that is, even if it assumes that other competitors would not follow its price increase.

85. The most serious unilateral effects concerns arise when the merged firm becomes by far the largest firm in the market. In every Telephia market but one (Brownsville TX), Sprint Nextel's market share is under 50% (and [ ] in Brownsville).[47] In contrast, Cingular and AT&T Wireless had a combined subscriber share of more than 50% in 30 of the Telephia markets. These markets, and Cingular's shares, are listed in Table 5. For example, absent divestitures, Cingular would have achieved a subscriber share of [ ] in Tupelo MS, [ ] in Hammond LA, and [ ] in Telephia's Texas 6-Jack market. Moreover, many of the markets in which Cingular had a dominant market share were

[47] In this market, T-Mobile is the next-largest competitor, with a market share of [ ].

located in the ILEC regions of BellSouth and SBC. In over a third of these 30 markets, the Commission conditioned its approval of the Cingular-AT&T Wireless merger on spectrum or asset divestitures.

86. At least three key economic factors may deter unilateral price increases – low diversion ratios between the merging parties, the ability of rivals to reposition and expand output in response to a price increase, and the efficiencies of the merger. We discuss these three factors in turn.

## B. Diversion Ratios and Closeness of Substitutes

87. The more distant substitutes are the products of the merging firms, the smaller is the post-merger incentive to raise price, other things equal. In the pre-merger market, a firm's profit-maximizing price is set at the level where the additional profits gained from the higher price charged to customers who remain with the firm are just equal to the profits lost from customers who switch to other firms, or purchase less. After the merger, the firm recaptures lost profits from the fraction of its lost customers who switch to the service of the now-acquired rival. This fraction is called the *diversion ratio* and affects the degree of profit recapture. As the diversion ratio decreases, the profit recapture rate decreases, and the incentive to raise price correspondingly declines.[48] As discussed below, there is no evidence that Sprint and Nextel are each other's next-best substitute. This suggests that the diversion ratio between them should be relatively small.

### 1. Customer focus

88. Sprint and Nextel do not share a common customer focus, which reduces the extent to which Sprint customers regard Nextel as a close substitute for Sprint, and similarly for Nextel's customers. Nextel's focus is much more skewed toward enterprise customers than is Sprint's. This

[48] As discussed earlier, if the wireless firm is owned by an ILEC, its profit recapture calculation will also include the diversion to and from its wireline operations, which can further raise its incentives to increase both wireless and wireline prices.

difference in focus also is reflected in part by the features that each promotes. Nextel is noted for its enterprise-friendly push-to-talk feature. In contrast, Sprint promotes color screen handsets, picture phones, data use, and the elimination of overages that are designed to appeal to non-enterprise customers.

### 2. Customer switching data

89. We have also reviewed data from Nextel and Sprint on customer switches following the introduction of wireless local number portability ("WLNP") and from exit surveys conducted by both merging parties. Evaluating subscriber switches by Nextel and Sprint subscribers can provide insight into the extent to which consumers regard Nextel and Sprint as close substitutes relative to other carriers. Although a single observation of switching behavior in a market may not always accurately measure long-term substitution behavior, switching patterns over a longer period of time can nonetheless be helpful in assessing whether two services are each other's closest substitutes. The data indicate that Sprint and Nextel are not each other's closest substitutes.

#### a) Number Portability Data

90. The WLNP data indicate that the subscriber switches between Sprint and Nextel are lower than those between each firm and their ILEC-affiliated competitors. Of the subscribers that left Nextel in 2004, only [ ] switched to Sprint. In contrast, [ ] of the lost Nextel subscribers switched to [ ] and [ ] switched to [ ] and [ ]. (See Table 6.)

91. Similarly, of the subscribers that left Sprint in 2004, only [ ] switched to Nextel. In contrast, [ ] of those Sprint subscribers switched to [ ] and [ ] switched to [ ] and [ ]. Thus, according to these data, Sprint and Nextel do not appear to be particularly close competitors.